

Economic Systems: Capitalism, Communism, and Socialism

An economic system consists of the institutions and the method by which resources are allocated and products and services are distributed. Economic systems differ primarily in who owns the [factors of production](#), how the [allocation of resources](#) is directed and the method used to direct economic activity. The primary distinction between the different systems is the degree to which the government participates in the economy.

Communism

Communism, also known as a **command system**, is an economic system where the government owns most of the factors of production and decides the allocation of resources and what products and services will be provided.

The most important originators of communist doctrine were **Karl Marx** and **Frederick Engels**. Like the socialists before them, they wanted to end the exploitation of the masses by the few. The capitalist system at that time required workers to work under harsh and dangerous conditions for little pay. The end goal of communism was to eliminate class distinctions among people, where everyone shared equally in the proceeds of society, when government would no longer be needed.

Karl Marx agreed with Louis Blanc in how labor and income should be managed: *"From each according to his abilities, to each according to his needs."* However, it seems clear from history that Adam Smith had the correct principle, which is that people work in their own self-interest.

Marx and Engels believed that there was a class struggle between the masses, which Marx referred to as the **proletariat**, who could only offer

their labor, and the owners of the means of production, which included land, raw materials, tools and machines, and especially money. Karl Marx called these members of the ruling class the **bourgeoisie**. He believed that a political revolution was essential because the state was a central instrument of capitalist society, and since the bourgeoisie had a stranglehold on the government, it would, in many cases, be necessary to use force and violence to overthrow the capitalists.

Although Marx and Engels believed that property should belong to society, they did not really give much thought to how economic decisions would be made. Communist countries, particularly Russia and China, decided on a **centrally planned economy** (aka **command economy**). The centrally planned economy had the following major attributes:

- The government owns all means of production, which is managed by employees of the state.
- These employees operate under party-appointed economic planners, who set output targets and prices and frequently interfered with the operations to satisfy personal or party desires.
- And because communist economies are not efficient and because of the Communist Party's desire to retain power, most economic resources were devoted to industrialization and to the military, depriving consumers of food and other necessary products, causing intense competition for these limited necessities, where many people had to wait in long lines for common consumer goods, such as toilet paper.

Another major feature of communist economies was their emphasis on the country's self-reliance, discouraging international trade and investment.

Major decisions were made by the highest-ranking members of the Communist Party, which, in the Soviet Union, was the Politburo. The Politburo frequently met with the Central Committee that consisted of the heads of the local Communist Party factions and government ministries, the military, police, and other major participants in the economy.

Although the purpose of communism was to serve the needs of the proletariat, communist governments simply became repressive regimes that exploited their people to aggrandize their own power, exploiting the masses even more so than the capitalists.

Capitalism

As long ago as 1776, the Scottish philosopher Adam Smith set down many of the main principles of capitalism in his now classic book [An Inquiry into the Nature and Causes of the Wealth of Nations](#).

Under **capitalism** (aka [market system](#)), each individual or business works in its own interest and maximizes its own profit based on its decisions. A market economy is one where the allocation of resources and the trading of goods and services are through the decentralized decisions of many firms and households. The [equilibrium between supply and demand determines prices](#), which determines economic output, which, in turn, determines the allocation of resources.

The market system fosters competition that generally produces the most efficient allocation of resources. In **pure capitalism**, also known as **laissez-faire capitalism**, the government's role is restricted to providing and enforcing the rules of law by which the economy operates, but it does not interfere with the market. (*Laissez-faire* means "let it be.")

The essential characteristics of capitalism are that:

- the factors of production are privately owned;
- economic transactions take place in markets, where buyers and sellers interact;
- businesses and employees are free to pursue their own self-interest and are motivated to do so by the potential to earn a profit;

Because consumers are free to buy what they want, the competition for their funds will require businesses to satisfy their needs, or else they will cease to exist due to lack of sales. This **consumer sovereignty** is what effects the efficient allocation of resources.

The main purpose of the government in regard to the economy is to promote free markets, keep [inflation](#) low and steady, protect the rights of private property, and to guarantee contracts, which are necessary to conduct business.

The **main benefit of capitalism is the promotion of competition**. Although capitalism is usually described as a private ownership of resources, it is [competition](#) that provides the main benefit to society; the private ownership of resources is necessary, but not sufficient, for competition. In laissez-faire capitalism, businesses become free to form [monopolies](#) or [oligopolies](#), which reduces competition, and thereby reduces the advantages of capitalism. Instead, a **plutocracy** is created, where the wealthy rule the economy for their own benefit.

Socialism

The definition of **socialism** varies widely, and many people use it synonymously for communism, but it is often distinguished as an economic system between communism and capitalism. **Socialism** is the social and economic doctrine that espouses public over private ownership and control of property and natural resources. Socialists argue that since everyone contributes to society in the form of work, therefore everyone should benefit from it. The degree of ownership or control differs among socialists. Some believe that the government should own most of the property and natural resources, while others believe that small businesses should be owned privately. Still others, mainly the rich, believe that simply taxing the rich more is a form of socialism.

Like communism, socialism seeks to redistribute the wealth more equitably by the communal ownership of natural resources and major industries, such as banking and public utilities. Socialists also seek to nationalize monopolies, which greatly enrich their owners at the expense of the people. However, unlike communism, most small or nonessential enterprises would remain privately owned. Also unlike the Communists, most socialists do not advocate violence or force to achieve their economic system.

Early socialist ideas centered on common ownership or control, equality, and the simple life. Some socialists advocated violence as a means of achieving their ends, but later socialists developed policies that envisioned a nonviolent means of achieving socialism. They wanted to revise Marx's teachings, by advocating that socialist successes could be achieved through the ballot box gradually, without violent revolution, and this was often accomplished by using political parties, such as the Labor Party of Great Britain. Thus, various forms of socialist ideals have developed. Some sample subtypes of socialist systems include the following:

- **Guild socialism** was based on the medieval guild, where an association of craftsman or other people of similar skills determine their own working conditions and activities. Some of these Guild socialists thought that there should be a government that coordinated the activity of the different guilds while others thought that the state should be limited to providing protection.
- **Fabian socialism** emphasized winning small battles over pitched battles. The Fabian society was named after the Roman general Fabius

Cunctator, who wore down Hannibal's armies through minor skirmishes rather than major battles. They advocated the social control of property by an impartial administration of enlightened experts.

- **The Social Democratic Party of Germany** (SPD) was formed in 1875 and exerted significant influence on German politics. A prominent revisionist of Marxism was Édouard Bernstein who lived in England for a while to escape the harassment of Otto von Bismarck, who, as Chancellor of Germany, tried to suppress the socialists and the SPD party in particular. While in England, Bernstein learned about the Fabians, and that laborers were achieving some success through trade unions. Since it was becoming clear that the conditions of the working class were improving rather than deteriorating, which was the opposite of what Karl Marx predicted, then improving working conditions and compensation may be better achieved through unionization and politics.

However, political strategies and unionization were not viable methods in countries like Russia, which was under authoritarian rule by the czars. Therefore, VI Lenin, who led the Bolshevik party of the Russian Social-Democratic Workers Party, realized that violence would probably be necessary to achieve socialism.

Lenin believed, as he argued in his book *What is to be Done?* (1902), that workers would only fight for better wages and working conditions, if they were led by a vanguard party of professional revolutionaries. The severe plight of the Russian people during World War I allowed the Bolsheviks to overcome the czarist regime and establish control. Thus, revolutionary Marxism was given a boost, which would be later used by other groups to gain control of their governments. Revolutionary Marxism eventually became known as Marxism-Leninism.

Some have advocated a **market socialism**: blending a free market economy with social ownership and control of property, where businesses would still compete for profit, but would be owned or at least be controlled by their laborers. The workers would choose their supervisors and managers, control the working conditions, set prices for the products and services, and decide how profits and losses will be shared.

Socialism in the modern world has yielded to the 3rd way, a center-left position committed to the socialists' objective of equality and welfare for the masses, but abandoning class-based politics and public ownership of

production. Tony Blair of the British Labour Party promoted this 3rd way in 1995. Two years later, the Labour Party won a large victory, and Tony Blair served as prime minister for 2 terms.

Economic Systems of the Future

History has amply demonstrated that communism and socialism retard the growth of economies, because there is no competition between businesses, and the people who manage such businesses are often political appointees, chosen more for their social and political connections than for their understanding of the businesses that they manage. Furthermore, large industries are often under the control of many bureaucrats, who often issue conflicting demands. They care little about whether society wants their product or service, and do not care as much about costs, since these costs are paid by the government.

To illustrate how inefficient communism is compared to capitalism, consider the difference between the 2016 Gross Domestic Products of Germany and Russia:

2016 GDP

Germany \$3,477,796,000,000

Russia \$1,283,163,000,000

Russia is, by far, the largest country in the world, with a landmass slightly exceeding 6,600,000 mi.², and natural resources proportional to its landmass. It also has a population of 144,370,000. By contrast, Germany's land area is 137,879 mi.², with a population of 83,249,000. And despite Russia having a landmass almost 48 times that of Germany, with proportionally greater natural resources, and a much larger population, Germany's GDP in 2016 was 2.7 times that of Russia! Although Russia is a major military power, it is an economic midget: it achieves its military prowess by devoting a much larger percentage of its GDP to military spending, which is why most of the people in Russia live in relative poverty. Other small countries with a GDP larger than Russia include: Japan, United Kingdom, France, Italy, and even South Korea.

Or consider the difference between North and South Korea:



Source: [NASA](#)

The Stark Contrast Between the Lights of Civilization and the Darkness of Poverty

As can be easily seen from this 2014 nighttime photograph from the space station, the lights of civilization are conspicuous in South Korea and China, but virtually absent from North Korea. The contrast is especially stark along the border separating North and South Korea. Indeed, most of North Korea looks like the ocean at night.

Of course, this stark contrast doesn't simply result from the difference between pure communism and pure capitalism, for such systems are nonexistent. The poverty in North Korea is created by their political leaders using the very limited resources of North Korea to help their leaders maintain political power. Kim Jong-un is diverting considerable resources to the production and testing of nuclear weapons and missiles to carry them, to develop the capability of destroying the United States that will serve as a deterrent to any attempt to topple his regime. That his people are suffering because of this massive diversion evidently does not faze him. Or, he may be seeking to use nuclear weapons to blackmail the rest the world, especially the United States. After all, after he develops hydrogen bombs and the missiles to carry them, what else can he do with them? His economy will still be in shambles, and since communist economies generally don't do well without, at least, some degree of freedom, it will probably be the only means of improving the lot of his people.

North Korea, Cuba, Russia, and China are really, more or less, dictatorships who promote the ideals of communism as propaganda, to convince the people that the government's exploitation of them is for their own good. However, the governing kleptocrats have no intention of ever relinquishing their power. In these dictatorships, it is the government exploiting the people rather than the capitalists. Here again, Adam Smith was right, people work for their own interest, including those in government. By allowing the government to own the means of production, they can also use that means to enrich themselves and their cronies at the people's expense. What Karl Marx did not realize is that government leaders are the same as capitalists, many of whom exploit who they can to enrich themselves. Even in the United States, lobbyists continually try to influence Congress and the president to pass laws in their favor, which is always at the expense of everyone else. (After all, if the laws were in the best interest of the people, then special interests wouldn't have to spend so much money to influence politicians to do otherwise, since, presumably, politicians would actually vote in the people's interest.)

Communism and socialism give great power to a few individuals who then become obsessed with retaining their power, even at the tremendous expense of society. For instance, Cuba and North Korea are almost completely communistic, and even though the Communist governments in both countries have controlled their countries for years, their people remain mired in abject poverty. Consequentially, the people of Cuba and North Korea are mere economic slaves who are used to enrich the communist dictators of these countries.

The other major problem with communism and socialism is that not only are the major leaders almost completely ignorant of [economics](#) and of the needs or wants of their people, but it is very difficult to remove them, in spite of their detriment to the economy. Even when a communist, such as Hugo Chávez in Venezuela, is elected in a democratic election, his primary goal is to retain his own power, even as the economy crumbles around him, because of gross mismanagement.

Capitalism works best because it promotes competition so that only the most efficient businesses survive. Survival requires that the business owners be knowledgeable about their business and able to manage it effectively, that they can minimize costs to produce their product or

service, and that they know what people want. Otherwise, the business will fail, as most do.

Thus, capitalism provides the best means of achieving the efficient allocation of the factors of production and providing society with the goods and services that it most desires at the lowest possible cost. Capitalism maximizes the [production possibility frontier](#), providing the greatest benefit to society with the available scarce resources.

Drawbacks of Capitalism

Although capitalism is the most effective means of allocating resources, it does have shortcomings, including the following:

- [monopolies](#) that can interfere with free enterprise and reduce allocation efficiency through their pricing power;
- free markets that do not price in [externalities](#), which is the effect that the production of a good or service has on people that is not related to the good or service itself, such as the creation of pollution in producing a product;
- without the direction of government, free markets do not produce [public goods](#), such as national defense, because public goods are non-excludable, meaning that people cannot be excluded from the benefit, even if they paid nothing for the public good.

A capitalist economy also requires a government to enact and enforce laws, to promote economic stability through [monetary policy](#), to provide services that cannot be provided by a market system, such as a military to protect society against foreign invaders, and to redistribute some of the wealth to poorer people, especially by providing social security programs, such as health care, which is unaffordable for many people. Because the government plays a prominent role in all economies, all capitalistic economies are considered **mixed economies**, combining some features of a command economy with a market economy.

The redistribution of some wealth is necessary, because even in a capitalist economy, some people gain tremendous wealth, then use it to influence governments to make them even wealthier, usually at the expense of poor people. For instance, in the United States, working income is taxed at a higher rate than either investment income or inherited income, income that accrues mostly to the wealthy. Although there is a [progressive, marginal income tax rate](#) in the United States, the tax is almost a flat tax when [payroll taxes](#) are added, and since payroll taxes do not apply to either investment income or inherited income, most wealthy people pay a lower percentage of their income in taxes

than either the middle class, or even many of the poor, which is one reason why the top 1% are accumulating an ever greater portion of the world's wealth.

No doubt that the science of economics will guide the development of future economies, fine tuning them by promoting what works and eliminating what doesn't work. But only if the influence of special interests and power grabs by megalomaniacs can be limited or eliminated. And by understanding economics, the electorate can avoid bamboozlement by specious advertising and talking points, and vote for politicians that would better serve the people instead of themselves.